STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AGL Resources, Inc., Nicor Inc., and Northern Illinois Gas Company d/b/a Nicor Gas Company	)	
	)	Docket No. 11-0046
Application for Approval of a Reorganization pursuant to Section 7-204 of the Public Utilities Act.	)	

INITIAL BRIEF OF STAFF OF THE ILLINOIS COMMERCE COMMISSION

JANIS E. VON QUALEN
Office of General Counsel
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701
(217) 785-3402
jvonqual@icc.illinois.gov

JENNIFER L. LIN
MEGAN C. McNEILL
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle St., Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
jlin@icc.illinois.gov
mmcneill@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

August 18, 2011

TABLE OF CONTENTS

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AGL Resources, Inc., Nicor Inc., and Northern Illinois Gas Company d/b/a Nicor Gas Company	)	
	)	Docket No. 11-0046
Application for Approval of a Reorganization pursuant to Section 7-204 of the Public Utilities Act.	)	

INITIAL BRIEF OF STAFF OF THE ILLINOIS COMMERCE COMMISSION

NOW COMES Staff ("Staff") of the Illinois Commerce Commission ("Commission"), by and through its undersigned counsel, pursuant to Section 200.800 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.800), and respectfully submits its Initial Brief in the instant proceeding.

I. INTRODUCTION & PROCEDURAL HISTORY

On January 18, 2011, AGL Resources Inc. ("AGL"), Nicor Inc. ("Nicor"), and Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas") (collectively, "Joint Applicants") filed an Application ("Application") seeking Commission approval of a reorganization pursuant to Section 7-204 of the Public Utilities Act ("Act") (220 ILCS 5/7-204).

In their Application, the Joint Applicants indicated that the reorganization would meet the requirements of Section 7-204(b)(1) through 7-204(b)(7) and 7-204(c) of the Act and submitted testimony from several different Nicor Gas and AGL witnesses.[1] The

[1] Operating Agreement issues were addressed in the Operating Agreement portion of this proceeding, which incorporated testimony and evidence from Docket No. 09-0301. Separate testimony was filed, a separate evidentiary hearing took place, and separate initial and reply briefs were filed.

following parties have intervened in this case: Illinois Attorney General ("AG"); Citizens Utility Board ("CUB"); Environmental Law & Policy Center ("ELPC"); Retail Energy Supply Association ("RESA"); Interstate Gas Supply of Illinois ("IGS"); and Local Unions 19, 117, 134, 150, 176, 364, 461, 701, International Brotherhood of Electrical Workers ("Unions"). Direct Testimony for this non-Operating Agreement portion of the docket was filed by the following Staff witnesses: Harold Stoller (Staff Ex. 6.0), Richard Bridal II (Staff Ex. 7.0), Dianna Hathhorn (Staff Ex. 8.0), Rochelle Phipps (Staff Ex. 9.0), David Rearden (Staff Ex. 10.0), Mark Maple (Staff Ex. 11.0R), and Darin Burk (Staff Ex. 12.0). Rebuttal Testimony was filed by the following Staff witnesses: Richard Bridal II (Staff Ex. 13.0), Dianna Hathhorn (Staff Ex. 14.0), Rochelle Phipps (Staff Ex. 15.0), David Rearden (Staff Ex. 16.0), Mark Maple (Staff Ex. 17.0), and Darin Burk (Staff Ex. 18.0). On July 19-20, 2011, an evidentiary hearing was held in Chicago.

Many issues have been resolved between the Joint Applicants and Staff as indicated by the Status Report which was filed by the Joint Applicants on July 13, 2011. This Initial Brief will give a short overview and summary of these resolved issues and then address contested issues.

II. RESOLVED ISSUES

A. Sections 7-204(b)(2) and (b)(3)

Sections 7-204(b)(2) and (b)(3) of the Act require that "the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers" and that "costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking

purposes." (220 ILCS 5/7-204(b)(2) and (b)(3)) Staff witness Hathhorn made nine recommendations with respect to approval of the proposed transaction under Section 7-204(b)(2)-(3) of the Act, which the Joint Applicants have accepted: (1) on the Operating Agreement, require AGL Services Company ("AGSC") to pay Nicor Gas fully distributed cost for services provided to AGSC; (2) on the AGSC Agreement, add an access to records paragraph; (3) on the AGSC Agreement, changes in allocation method will be filed with the Commission; (4) an annual Internal Audit will be required on the AGSC Agreement; (5) a triennial cost study will be required of the services provided under the AGSC Agreement; (6) the annual filing of a Billing Report for the AGSC Agreement will be required; (7) human resources-related costs will be directly charged or assigned; (8) the Joint Applicants will file an executed copy of the Tax Allocation Agreement on e-Docket; and (9) the Joint Applicants will file the final disposition of journal entries on e-Docket. (*See* Staff Ex. 8.0, JA Ex. 10.0, and JA Ex. 15.0)

Staff witness Rearden made three recommendations with respect to approval of the proposed transaction under Section 7-204(b)(2)-(3), which the Joint Applicants have accepted: (1) Sequent Energy Management ("Sequent") will not be a party to the Nicor Gas Operating Agreement; (2) all agreements with Sequent apart from standard NAESB agreement (asset management agreement, Hub administration) will be covered in separate agreements with separate Commission approval; and (3) there will be no right of last refusal for Sequent on spot purchases. (*See* Staff Ex. 10.0, JA Ex. 8.0, and JA Ex. 13.0)

B. Section 7-204(b)(4)

Section 7-204(b)(4) of the Act requires that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure," (220 ILCS 5/7-204(b)(4)) Staff witness Phipps made two recommendations with respect to approval of the proposed transaction under Section 7-204(b)(4), which the Joint Applicants have accepted: (1) there will be a separate credit facility for Nicor Gas; and (2) a compliance report will be filed following reorganization providing copies of post-merger Nicor Gas credit facilities. (*See* Staff Ex. 9.0 and JA Ex. 9.0)

C. Section 7-204(b)(5)

Section 7-204(b)(5) of the Act requires that the Commission must find, in order to approve a proposed reorganization, that, among other things, "the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities." (220 ILCS 5/7-204(b)(5)) Staff witness Burk made six recommendations, as revised in rebuttal testimony, with respect to approval of the proposed transaction under Section 7-204(b)(5), which the Joint Applicants have accepted: (1) through (4) maintain specified number of employee positions in Illinois for five years and related commitments; (5) Nicor Gas will petition the Commission 90 days prior to the end of the five year period to determine whether Nicor Gas' performance concerning pipeline safety issues is reasonably comparable to pre-reorganization levels at Nicor Gas, or requires an extension of the commitment period beyond five years; and (6) Nicor Gas will review the petition and performance with Staff 60 days before filing the petition. (*See* Staff Ex. 12.0, Staff Ex. 18.0, and JA Ex. 13.0)

Further, with the Joint Applicants' agreement to resolve the issues presented in Mr. Burk's direct testimony, as Mr. Burk indicated in his rebuttal testimony, it is Staff witness Stoller's position that the proposed transaction meets the requirements of Section 7-204(b)(5). (*See* JA Ex. 13.2)

D. Section 7-204(b)(6)

Section 7-204(b)(6) of the Act requires that "the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction." (220 ILCS 5/7-204(b)(6)) Staff witness Rearden recommended that the Commission find as required under Section 7-204(b)(6), that the proposed transaction is not likely to have a significant adverse effect on competition for both the small customer transportation market and the large customer transportation market. (*See* Staff Ex. 10.0 and Staff Ex. 16.0)

E. Section 7-204A(a)(5)

Section 7-204A(a)(5) of the Act requires that an application for approval of a reorganization shall include "a copy of any proposed agreement between the public utility and any person with which it will be an affiliated interest…" (220 ILCS 5/7-204A(a)(5)) The Joint Applicants' submission with respect to the minimum filing requirements under Section 7-204A(a)(5) included four existing agreements between Nicor Gas and Sequent submitted for approval as affiliate interest agreements post-reorganization. Staff witness Rearden recommended approval of these agreements. (*See* Staff Ex. 10.0)

F. Other

Staff witness Phipps made two recommendations with respect to approval of the proposed transaction, which the Joint Applicants have accepted: (1) Nicor Gas will file a post-merger report on its capitalization to address Section 6-103 of the Act and, if there are push down accounting adjustments to Nicor Gas' balance sheet, then Nicor Gas will also file a petition seeking Commission approval of a fair value study and resulting capital structure; and (2) will revise Nicor Gas' short-term borrowing addendum to the Operating Agreement to comply with the Commission's money pool rules (83 Ill. Adm. Code 340). (*See* Staff Ex. 9.0 and JA Ex. 9.0)

III. CONTESTED ISSUES

A. Section 7-204(b)(1)

Section 7-204(b)(1) of the Act requires the applicants to demonstrate that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service..." (220 ILCS 5/7-204(b)(1))

The burden of proof is on the Joint Applicants to establish that they will operate the utility going forward in a manner that either meets or exceeds the level of service currently provided by Nicor Gas in every facet of the operations. Staff determined that the only means by which the Joint Applicants can satisfy this burden is to reveal to Staff and the Commission their detailed final integration plans for all of the various operations of the utility. (Staff Ex. 17.0, p. 13) Only then can the Commission properly evaluate whether the proposed merger will diminish the quality of service going forward. Because the Joint Applicants have failed to provide those plans, or any material information in this regard, Staff determined that the Commission cannot make the

requisite finding that the proposed reorganization will not diminish Nicor Gas' ability to provide adequate, reliable, efficient, safe, and least-cost public utility service. Therefore, Staff recommends that the Commission should not approve this reorganization.

Despite the burden of proof belonging to the Joint Applicants, Staff provided multiple opportunities for Nicor Gas and AGL Resources to provide information that the Commission could use to satisfy Section 7-204(b)(1). In Staff data request ("DR") DLH 2.05, Staff asked for all due diligence reports that the Joint Applicants created or relied upon. A thorough due diligence review would look into all aspects of a company, such as financial records, personnel, legal and regulatory issues, physical assets, and operational procedures and costs. It would be typical for the people performing the review to take detailed notes and prepare due diligence reports for the review of the acquiring company's officers and directors. (Staff Ex. 11.0, p. 4) However, AGL Resources apparently performed very little, if any, of this type of review before committing to acquire Nicor Gas, as it created very few reports to document its review. (*Id*., p. 10) In fact, Mr. Linginfelter stated that "AGL Resources did not have to prepare due diligence reports to know about Nicor Gas' operations" (JA Ex. 8.0, p.8). However, AGL has not provided any substantive information demonstrating that AGL familiarized itself with the physical system and operations of Nicor Gas. (Staff Ex. 17.0, p.9) If AGL Resources had a detailed knowledge of Nicor Gas' trade secrets and confidential operational information, AGL should have provided that information in response to Staff's inquiries. The inability of AGL to respond to requests for detailed information on Nicor Gas' operations makes it impossible to conclude that AGL Resources has an intimate knowledge of the operations. It appears that AGL Resources was far more

concerned with purchasing a profitable company with valuable gas storage assets and much less concerned with the details of actually operating a utility that serves the needs of over 2 million ratepayers.

AGL Resources claims that it relied upon mostly public documents during its review of Nicor Gas, and did not need to consider the vast collection of confidential Nicor data. While AGL Resources' witness Linginfelter argues that there is plenty of valuable public information available for review (JA Ex. 8.0, p. 7), he ignores the fact that most of it deals with financial and accounting issues, not operational information. (Staff Ex. 17.0, p. 10) AGL Resources has not identified any public documents which it reviewed that examine the condition of Nicor Gas' distribution system, evaluate Nicor Gas' supply portfolio, discuss operational challenges of Nicor Gas' underground storage fields, or investigate any of other dozens of critical operational aspects of Nicor Gas' system. One can only surmise that AGL Resources reviewed nothing of this sort before offering to acquire Nicor Gas.

The due diligence reports are just one way that AGL Resources could have demonstrated to Staff and the Commission that it understands Nicor Gas' system, understands the challenges it will face, and is prepared to offer service that is undiminished from Nicor Gas' current level. Failing to make such a demonstration, AGL Resources still had an opportunity to satisfy Section 7-204(b)(1) of the Act by detailing how it planned to operate the Nicor Gas system going forward. Staff sent several data requests asking the Joint Applicants to explain how they intended to operate and maintain Nicor Gas' gas distribution system, gas transmission system, and gas storage system. (See Staff Group Cross Ex. 2, pp. 1-2, JA Responses to Staff DRs MEM 1.08-1.09; Staff Ex. 11.0R, Attachment 1) Staff also asked how the Joint Applicants intended

to change Nicor Gas' current gas supply and materials procurement methods, how they intended to efficiently integrate AGL Resources' and Nicor Gas' pipeline capacity and storage assets, and how they will integrate their gas control functions. (See Staff Group Cross Ex. 2, pp. 3-5, JA Responses to Staff DRs MEM 1.10, 1.12, and 1.16) These questions represent the core functions of Nicor Gas' business – buying, selling, and distributing gas. In each instance, the Joint Applicants answered that they were in the midst of the integration planning process, and thus could not answer the question. (Staff Ex. 11.0R, pp. 10-13) Mr. Linginfelter was also asked during cross examination whether the Joint Applicants had performed an analysis to determine the long-term operational benefits that would inure to Nicor Gas' customers because of the merger. His answer was that the Joint Applicants had performed no such analysis. (Tr., July 19, 2011, p. 595)

The only conclusion to be drawn from these answers is that the Joint Applicants have no idea how any aspect of the newly merged company will operate going forward. The Company cannot demonstrate which employees it will retain and which it will terminate. (Staff Ex. 17.0, p. 4) It cannot list the standards and practices by which they will operate. (Staff Ex. 11.0, pp. 10-12) They cannot explain how they will maintain the transmission, distribution, and storage systems in a safe and useable manner (Id). They cannot explain how they will purchase, transport, and sell gas in the most efficient manner (Id). Despite this total lack of evidence to satisfy their burden of proof, the assert that the Commission should find that the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. Such a conclusion would be a leap of faith; there is no evidence in the record to support it.

The Joint Applicants seem to be asking the Commission to trust their experience and promises instead of providing plans and facts to satisfy Section 7-204(b)(1). As Mr. Linginfelter points out, "Nicor Gas has a history of providing safe and adequate service." (JA Ex. 8.0, p. 6) However, Nicor Gas' history of providing safe and adequate service does not address what effect the proposed reorganization will have on its ability to continue to provide reliable service. (Staff Ex. 17.0, p. 5) Mr. Linginfelter also states, "Nicor Gas is the low-cost provider of gas distribution service in Illinois today … Staff did not contest this fact in its direct testimony. That model matches the cost management philosophy of AGL Resources. Nothing that we plan will impair Nicor Gas' ability to keep that distinction" (JA Ex. 8.0, p. 6) Again, the Joint Applicants do nothing to show that the reorganization will not diminish service going forward. If anything, AGL Resources' apparent total lack of interest in Nicor Gas' operations should heighten concerns over whether, after the reorganization, Nicor Gas will continue to be the low-cost provider of gas distribution service. Neither does the statement that "[n]othing we plan will impair Nicor Gas' ability to keep that distinction" with no documentation as to what they plan provide any fact upon which to base a finding that there will be no diminution of service. (Staff Ex. 17.0, p. 5)

Staff is not debating that Nicor Gas is currently serving customers adequately, reliably, efficiently, safely, and at the least cost possible. However, this has nothing to do with the findings required in this docket. If anything, Nicor Gas' success has set a very high bar that AGL Resources may find difficult to maintain. Additionally, the Joint Applicants have provided nothing in writing that demonstrates how they will continue to operate Nicor Gas at such a high level. Mr. Linginfelter has said that "the Commission should heavily weight the commitment AGL Resources has made relating to the staffing

of Nicor Gas operations subsequent to completing the Reorganization." (JA Ex. 8.0, p. 5) But the facts show that the Joint Applicants are committing only to retain "equivalent" employee hours for a three year period and that Nicor Gas employees could be let go, assigned to other duties, or even work for other AGL Resources' affiliates while AGL Resources' employees in another state work for the Nicor Gas utility (Tr., July 19, 2011, p. 573) Any significant shift in personnel or job duties would likely diminish the quality of service compared to Nicor Gas' current level.

Essentially, the Joint Applicants have provided no evidence for the Commission to consider as it relates to Section 7-204(b)(1). Statements about corporate core values and vague commitments do not explain how gas will get from Texas or Canada to the customer's house, and how AGL Resources will do it safely, reliably and cost effectively. Staff gave the Joint Applicants multiple opportunities to lay out plans for integrating the two companies, and the Joint Applicants failed every time to give any meaningful answers. To determine what recommendation to make regarding whether the reorganization would diminish Nicor Gas' ability to provide adequate, reliable, efficient, safe and least cost service, Staff requested the Joint Applicant's technical plans and procedures. It was Staff's intent to use its expertise to review and analyze the information and provide Staff's analysis to assist the Commission in its decision making process. In this docket, Staff had absolutely nothing to evaluate. The Joint Applicants provided Commission and its Staff no analysis to consider, no integration studies, no revised standards, no due diligence reports – absolutely nothing of substance to demonstrate they have any specific knowledge about how Nicor Gas operates or how they intend to operate going forward. For these reasons, Staff cannot recommend that the Commission approve the Joints Applicants' petition.

B. Section 7-204(b)(7)

1. Summary of Staff Position

Without a cap on Nicor Gas' common equity ratio, the proposed reorganization does not satisfy the requirements set forth in Section 7-204(b)(7) of the Act since the Joint Applicants have not identified a specific, effective means for eliminating the adverse rate impact of the expected decline in Nicor Gas' credit ratings. (Staff Ex. 15.0, p. 6)

2. Legal Standard

The Joint Applicants argue that Section 7-204(b)(7) requires the Commission to consider the ultimate impact of the entire reorganization on customer rates. (JA Ex. 9.0, p. 6) Staff disagrees with that interpretation because it fails to recognize the Commission's statutory obligation under Section 9-230 of the Act to remove every iota of incremental risk in Nicor Gas' cost of capital that is due to its affiliation with non-utility companies.

> In section 9-230, the legislature used the word "any" to modify its prohibition of considering incremental risk or increased cost of capital in determining a reasonable ROR. This usage removes all discretion from the Commission. Section 9-230 does not allow the Commission to consider what portion of a utility's increased risk or cost of capital caused by affiliation is "reasonable" and therefore should be born by the utility's ratepayers; the legislature has determined that any increase whatsoever must be excluded from the ROR determination. It is impermissible for the Commission to substitute its reasonableness standard for the legislature's absolute standard. *Illinois Bell Telephone v. Illinois Commerce Commission,* 283 Ill.App.3d 188, 669 N.E.2d 919, 207, 933 (Second Distr., 1996)

The Section 9-230 prohibition is effective regardless of whether a utility can offset such an increase in the cost of capital with other sources of savings. Therefore, unless the Commission is able to remove every iota of incremental risk reflected in Nicor Gas' cost of capital that results from its affiliation with non-utility companies, the proposed reorganization will result in an adverse rate impact. (Staff Ex. 15.0, p. 3)

3. Nicor Gas' Credit Ratings

a. Likelihood of Downgrade

Ms. Phipps testified that Nicor Gas' credit ratings are expected to decline following the reorganization as a consequence of becoming a subsidiary of AGL Resources, an entity with higher financial risk than Nicor Gas' current parent company, Nicor. Lower credit ratings would lead to higher debt costs, which in turn, would lead to higher equity costs since higher debt costs increase financial risk. Since the cost of capital is a component of a utility's rates, then an increase in financial risk could increase a utility's rates. (Staff Ex. 9.0, p. 15)

Ms. Phipps explained that higher financial risk could sometimes reduce the cost of capital if the higher financial risk is a consequence of an increase in the proportion of debt in the capital structure. This could cause the cost of capital to decline due to the resulting shift in weight from higher cost common equity to lower cost debt. (Staff Ex. 9.0, p. 15) Towards that end, the Joint Applicants acknowledge that increasing the proportion of debt in a capital structure (also referred to as "financial leverage") can lower the pre-tax cost of capital. (Tr., July 19, 2011, pp. 484-485 and 492) Nevertheless, the Joint Applicants intend to maintain Nicor Gas' equity ratio at levels similar to those historically maintained for Nicor Gas, or approximately 56%. (JA Ex. 3.0, p. 10; JA Ex. 3.2) Therefore, there would be no increase in the proportion of debt comprising Nicor Gas' capital structure to offset increases in Nicor Gas' debt and equity costs. (Staff Ex. 9.0, pp. 15-16)

The Joint Applicants claim that it is unknown whether there will even be downgrades to Nicor Gas' credit ratings following the reorganization. (JA Ex. 9.0, p. 2) Although nothing concerning the ultimate effect of the proposed reorganization on Nicor Gas' credit ratings is known with complete certainty, both Standard &Poor's ("S&P") and

Moody's Investors Service ("Moody's") have expressed that they expect to downgrade Nicor Gas' credit ratings following the merger. Importantly, S&P rates affiliates on a consolidated basis absent legal and regulatory barriers insulating a company from its affiliates; that is, S&P credit ratings reflect the creditworthiness of the consolidated entity. Since the Joint Applicants do not intend to take steps to insulate Nicor Gas from non-utility affiliate risks following the proposed reorganization (with the exception of not including Nicor Gas as a lender in any money pools), then it is likely that Nicor Gas' S&P credit ratings will decline following the reorganization.[2] (Staff Ex. 15.0, pp. 1-2) Similarly, Moody's states:

> A one-notch downgrade for Nicor gas is subject to AGL obtaining a reasonable merger approval from the ICC that would not contain any material restrictions with respect to Nicor Gas's ability to upstream dividends to its new parent while continuing to maintain its credit metrics around its current strong levels…Nicor Gas's outlook could be stabilized in the ICC were to place restrictions on the amount of dividends that could be upstreamed or if Nicor Gas were not to be included in AGL's money pool.

(Staff Group Cross Ex. 2 (Public), pp. 21-22)

The Joint Applicants' claim that they are insulating Nicor Gas by not including the utility in AGL Resources money pools does not address the lack of insulation between Nicor Gas and AGL Resources with respect to Nicor Gas' ability to upstream dividends to its parent company following the reorganization. For example, the Joint Applicants could not specify whether the consent of an independent director would be required before Nicor Gas would pay dividends to AGL Resources. (Tr., July 19, 2011, pp. 483-484) Consequently, Moody's could still determine that Nicor Gas' ratings should be

[2] When referring to an "expected event", "expected" is synonymous with "likely." Among the definitions of "expect" in its form as a transitive verb is "to consider probable or certain." http://www.merriam-webster.com/dictionary/expect

downgraded one notch. Further, even though Nicor Gas will issue its own debt following the reorganization, at least one of Nicor Gas' credit ratings will be lower than it is today, given the consolidated rating approach that S&P employs.

b. Effect of a Downgrade on Nicor Gas' Cost of Capital

A downgrade to Nicor Gas' long-term ratings would likely lead to a downgrade in Nicor Gas' commercial paper ratings. Thus, it follows that Nicor Gas' debt costs will increase following the reorganization due to one or more credit rating downgrades because lower credit ratings denote higher risk and investors require higher returns for riskier investments. (Tr., July 19, 2011, p. 493)

Even more troublesome than increasing debt costs will be the increase to Nicor Gas' cost of equity due to lower post-merger credit ratings. The Joint Applicants claim that there is no evidence the cost of equity for Nicor Gas would change materially due to the reorganization because the proxy group of comparable gas utilities is not expected to change for Nicor Gas due to the Reorganization (JA Ex. 9.0, p. 9), but this claim incorrectly confuses the cost of common equity of the proxy group for the cost of common equity for Nicor Gas. The total risk of Nicor Gas is expected to increase after AGL Resources acquires Nicor Gas because AGL has more financial risk than Nicor. More financial risk is expected to cause Nicor Gas' credit ratings to decline. Thus, even if the peer group of comparable companies does not change in future rate proceedings, an adjustment to the cost of equity for the peer group to reflect the risk of Nicor Gas vis-à-vis the comparable sample would be necessary. (Staff Ex. 15.0, p. 5)

4. Joint Applicants' Surrebuttal Proposal

The Joint Applicants offer a proposal in surrebuttal testimony (hereafter, the "surrebuttal proposal") that provides, in any rate proceeding during the three years immediately following the closing date of the reorganization, the appropriate debt and equity costs should be based on a study that assumes Nicor Gas' credit rating has not changed following the reorganization. In rate proceedings following the three-year anniversary of the closing date of the reorganization, the Joint Applicants propose to file a study addressing the requirements of Section 9-230 of the Act, including analyzing any impact of Nicor Gas' affiliation with AGL Resources and its other subsidiaries on Nicor Gas' cost of capital. (JA Ex. 14.0, pp. 7-8)

The surrebuttal proposal is deficient in that it lacks specificity as to how it would be implemented. The surrebuttal proposal does not specify who would perform the proposed studies, who would pay for the studies, what role if any the Commission would have in directing the studies, what capital structure would be used in the studies or how the cost of common equity would be determined for the studies. (See Tr., July 19, 2011, p. 498) Due to the vagueness of the surrebuttal proposal, and the problems inherent in the proposal, it continues to fail to satisfy the requirements of Section 7-204(b)(7). The problems inherent in the surrebuttal proposal are categorized for discussion below as follows: (1) the portion of the proposal that would govern the first three years following the merger; (2) the portion of the proposal that would govern year four and beyond; and (3) conceptual concerns.

a. Surrebuttal Proposal: Years 1 through 3

The surrebuttal proposal specifies nothing more than that the Joint Applicants will provide a study that estimates debt and equity rates for post-merger Nicor Gas that assumes Nicor Gas maintains its AA/A2 credit ratings. Importantly, the surrebuttal proposal does not specify the capital structure to which those estimated debt and equity rates would be applied. During cross-examination, the Joint Applicants' witness confirmed that the Joint Applicants do not have a specific proposal as to what capital structure would be used. (Tr., July 19, 2011, pp. 495-496) The problem arises because adjusting debt and equity costs based on Nicor Gas' pre-merger credit ratings implies that the capital structure needed to support Nicor Gas' pre-merger credit ratings is reasonable for establishing utility rates. Otherwise, there would be a mis-match between the capital structure and the costs of debt and equity. By virtue of adopting the surrebuttal proposal, the Commission would also be ruling that Nicor Gas' capital structure should be sufficiently strong (and costly) to support AA/A2 credit ratings even though it is possible that Nicor Gas' pre-merger credit ratings will not be commensurate with the risk of its post merger capital structure. The surrebuttal proposal neither recognizes this nor proposes a remedy if that would occur.

Second, the Joint Applicants have not proposed a methodology for the Commission to determine what Nicor Gas' cost of debt and equity would be absent the reorganization. Estimating the cost of equity is far more complicated than estimating the cost of debt for which there are published interest rates for short- and long-term debt that vary according to credit rating. (Tr., July 19, 2011, pp. 500-502) That is, equity holders receive residual returns, which are more uncertain than the contractual returns that are due to debt holders. This concept can be illustrated using an example for a

hypothetical utility whose investors require $6 million for the return on equity and $4 million for the return on debt (for operating income totaling $10 million). Debt holders will always receive their required return of $4 million as long as the utility realizes operating income of $4 million or higher whereas the shortfall in all returns under $10 million but more than or equal to $4 million will be borne by common shareholders. (Tr., July 19, 2011, pp. 485-487)

Furthermore, adjusting a proxy group's cost of common equity estimate due to differences in risk between that sample and a company with a hypothetical credit rating in a manner that would meet the legal standard of Section 9-230 is problematic and would rely largely on guesswork rather than rigorous quantitative analysis. Consequently, the surrebuttal proposal would make it impossible for the Commission to know whether it has met its obligation to remove the last iota of the increase in cost of common equity due to Nicor Gas' affiliation with non-utility and unregulated companies.

b. Surrebuttal Proposal: Year 4 and Beyond

Following the three-year anniversary of the reorganization, the surrebuttal proposal would provide a study addressing the requirements of Section 9-230 of the Act, including analyzing any impact of Nicor Gas' affiliation with AGL Resources and its other subsidiaries on Nicor Gas' cost of capital. The parameters of this study are more vague than the study offered for the first three years. It is unclear whether this latter study would provide hypothetical debt and equity cost rates, adjust the capital structure, or take a different approach altogether. The Joint Applicants do not specify how their proposal would permit the Commission to determine the effect that non-utility and unregulated affiliates have on Nicor Gas' cost of capital, including how the Commission

would determine what the credit rating, cost of debt and cost of equity would be for Nicor Gas absent non-utility and unregulated affiliates.

Furthermore, the Joint Applicants' surrebuttal proposal is unclear with respect to the purpose such a study would provide if the Commission determines that Nicor Gas' capital structure is unreasonable independent of Nicor Gas' affiliation with AGL Resources or other non-utility and unregulated entities. Finally, the Joint Applicants also have not specified whether other parties would be able to propose alternative means for removing the incremental effect of Nicor Gas' affiliation with non-utility or unregulated companies from Nicor Gas' rate of return.

c. Surrebuttal Proposal: Conceptual Concerns

The surrebuttal proposal fails to identify the entity(ies) that would perform the proposed studies, whether the Commission would play a role in selecting or approving the persons or entities that would conduct the study, or who would pay for the proposed studies. (Tr., July 19, 2011, pp. 494-495 and 504) Those questions warrant attention, especially since a study performed by either the Joint Applicants or an agent on behalf of the Joint Applicants would require the same scrutiny as the rate case filing itself, which may place a greater burden on Staff and the Commission than would exist without the study. Staff would have to scrutinize any study performed under the control of the utility because of the disincentive for the utility to come to a finding that a reduction in Nicor Gas' authorized rate of return is necessary to meet the requirements of Section 9-230. Importantly, it is not clear how many years this condition would remain in place following the reorganization. Although Section 9-230 requirements are

indefinite, the value of a study that compares post-merger Nicor Gas with a Nicor Gas that no longer exists would surely diminish as the time horizon lengthens.

AGL Resources' capital structure comprises 60% debt, which is substantially more than Nicor Gas' 43% debt ratio. (Staff Group Cross Ex. 2 (Conf.), p. 76; JA Ex. 3.2) Importantly, the Joint Applicants view AGL Resources' credit ratings and capital structure as very efficient and providing reasonable access to the capital markets. (Tr., July 19, 2011, p. 491-492) Therefore, no financial reason exists for Nicor Gas' capital structure to be different from AGL Resources' capital structure, particularly since they will have the same credit rating from S&P. Importantly, absent an adjustment to Nicor Gas' capital structure to reflect the degree of leverage commensurate with its post-merger credit rating, ratepayers could end up paying rates that combine a high equity ratio that is characteristic of pre-merger, AA-rated Nicor Gas with the higher debt and equity costs that reflect post-merger, BBB-rated Nicor Gas. Such a mis-match would essentially cause ratepayers to suffer "the worst of both worlds."

In summary, the Commission should reject the Joint Applicants' surrebuttal proposal because it is overly complicated and does not specifically address Staff's overarching concern regarding the potential for including even one iota of incremental cost in Nicor Gas' cost of capital due to its affiliation with unregulated and non-utility companies, which would violate Section 9-230 of the Act.

5. Staff Proposed Condition

Given (1) the strong likelihood that at least S&P, if not also Moody's, would downgrade Nicor Gas' credit ratings as a direct consequence of the proposed reorganization; (2) that such a credit rating downgrade would lead to higher debt and

common equity costs; and (3) that without an offsetting increase in the percentage of debt in Nicor Gas' capital structure those higher costs of debt and common equity would lead to higher rates, Nicor Gas customers would likely suffer adverse rate impacts following the proposed reorganization. Therefore, in order to ensure the proposed reorganization will satisfy the requirements set forth in Section 7-204(b)(7) of the Act, the Commission should require that, in future ratemaking proceedings, Nicor Gas' post-merger capital structure contain no more common equity than the post-merger capital structure of its parent company, AGL Resources, provided AGL Resources maintains issuer credit ratings of BBB-/Baa3/BBB-, or better, from S&P/Moody's/Fitch. Staff recommends that this condition represent a ceiling on Nicor Gas' post-merger equity ratio for ratemaking purposes, rather than a floor, in order to provide interested parties the opportunity to propose capital structures, capital structure adjustments or a hypothetical capital structure in future rate cases for Nicor Gas. (See Tr., July 20, 2011, pp. 792-793)

This condition, if adopted, would assist the Commission in avoiding any mismatch between the capital structure and corresponding cost rates that could be excessively costly for Nicor Gas customers. (*Id*.)

Aligning Nicor Gas' capital structure and capital component cost rates would effectively remove any incremental cost resulting from a potential mis-match between the Company's post-merger capital structure, debt and equity costs, and thereby resolve Staff's concerns regarding the Section 7-204(b)(7) criterion. Furthermore, this approach would render estimating Section 9-230 related adjustments to debt and equity cost rates unnecessary and eliminate the need for post merger studies, which are problems Staff identified in the Joint Applicants' surrebuttal proposal.

6. Conclusion

Unless the Commission adopts Staff's proposed ceiling on Nicor Gas' post-merger common equity ratio, the proposed reorganization does not satisfy the requirement set forth in Section 7-204(b)(7) of the Act since without an increase in the proportion of debt in Nicor Gas' capital structure, the likely declines in Nicor Gas' credit ratings will increase its cost of capital. Illinois law prohibits the Commission from including *any* incremental risk or increased cost of capital which is the direct or indirect result of the public utility's affiliation with unregulated or non-utility companies. (220 ILCS 9-230, emphasis added) By use of the word 'any' the legislature has established a "zero tolerance" policy for such an increase in the cost of capital. (See *Illinois Bell Telephone v. Illinois Commerce Commission*, 283 Ill.App.3d 188, 669 N.E.2d 919, 207, 933) Illinois law also requires that before approving a reorganization, the Commission must find that the reorganization is not likely to result in any adverse rate impacts. (220 ILCS 7-204(b)(7)) As discussed above, the proposed reorganization is likely to result in a downgrade of Nicor Gas' credit ratings. Lower credit ratings would lead to higher debt costs, which in turn, would lead to higher equity costs since higher debt costs increase financial risk. Since the cost of capital is a component of a utility's rates, then an increase in financial risk could increase a utility's rates. The increase in rates would be the result of Nicor Gas' affiliation with non-utility company AGL Resources (See 220 ILCS 5/9-230), and therefore constitutes an adverse rate impact under Section 7-204(b)(7) of the Act.

C. Section 7-204(c)

1. Summary of Staff's Recommendation

In the event that the Commission should approve the proposed reorganization, the Commission should also make the following rulings as required by Section 7-204(c) of the Act:

a) All savings resulting from the proposed reorganization shall be flowed through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission (Section 7-204(c)(i) of the Act); and

b) Any costs incurred in accomplishing the proposed reorganization in this or any future proceeding shall not be recoverable through Illinois jurisdictional regulated rates (Section 7-204(c)(ii) of the Act).

As explained further below, only by making these rulings can the Commission fulfill the requirements of Section 7-204(c) of the Act.

2. Requirements of Section 7-204(c) of the Public Utilities Act

In its consideration for approval of a proposed reorganization, the Act requires the Commission to make certain findings regarding savings[3] resulting from the proposed reorganization, and costs incurred in accomplishing the proposed reorganization. Specifically, Section 7-204(c) of the Act states:

> The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated. [Emphasis added]

[3] The term "savings" in Section 7-204(c)(i) refers to an actual reduction in costs or expenses. (Amendatory Order on Rehearing, Docket No. 98-0555, November 15, 1999, p.146)

As such, if the Commission should approve the proposed reorganization, it must make two separate findings under Section 7-204(c).

The first required finding is determining how any savings resulting from the proposed reorganization should be allocated among the operating utility, its holding company, its affiliates, its stockholders, and its ratepayers. Staff's position is that all savings resulting from the proposed reorganization be flowed through to the costs associated with regulated intrastate operations for consideration in setting rates by the Commission.

The second required finding is two-fold: (a) determining whether the Joint Applicants should be allowed to recover any costs incurred in accomplishing the proposed reorganization, and (b) if so, determining what amount of cost is eligible for recovery and how those costs should be allocated among the operating utility, its holding company, its affiliates, its stockholders, and its ratepayers. Staff's position is that no costs incurred in accomplishing the proposed reorganization should be recovered from Nicor Gas ratepayers. Because Staff recommends zero cost be recovered, there is no need for a Commission finding on the allocation of recoverable cost.

3. Allocation of Savings Resulting from the Proposed Reorganization

Throughout pre-filed testimony, data request responses, and cross examination, the Joint Applicants and their witnesses have time and again repeated the same refrain: the proposed reorganization will not result in any savings[4]. They also state they have performed no analysis or calculations to determine what savings, if any, could result

[4] See, for example, Tr., July 19, 2011, p. 546.

from the proposed reorganization[5]. Yet, the Joint Applicants want assurance that if in the future some other party performs the analysis and calculations of savings which the Joint Applicants failed to provide, and if that party requests rates be reduced to incorporate those savings, the Joint Applicants could argue that those savings should be reduced by costs to achieve those savings, including costs incurred in accomplishing the reorganization. (JA Ex. 13.0, p. 17)

The Commission should reject the Joint Applicants' proposal. The Joint Applicants had ample opportunity to perform their own analysis and calculations of savings, but instead chose not to do so and simply stated there would be no savings. The Joint Applicants had ample opportunity to identify potential savings and suggest a manner in which those savings should be allocated, but again, chose not to do so. There are no expected savings identified by the Joint Applicants, and there is no competing proposal of how savings should be allocated. The Commission must conclude that any savings that might be recognized from the reorganization will be attributable solely to utility operations, and, thus, should be flowed directly to the ratepayers. (Staff Ex. 7.0, p. 3) In fact, the Joint Applicants came very close to agreeing with Staff's recommendation to flow through savings to the costs associated with the regulated intrastate operations for consideration in setting rates, when Joint Applicants witness Linginfelter testified:

> But just generally, I think to answer your question more directly, our intent is over a period of years, your statement is absolutely correct, eventually it doesn't matter, the costs are what the costs are and a normal rate case would deal with savings, costs, increases in costs, what's not allowed, what is allowed in terms of recovery. That would be very typical. (Tr., July 20, 2011, p. 687)

[5] See, for example, *Id*., p. 602.

It should be noted that Staff's recommendation that all savings be flowed through to ratepayers does not in itself mean that all of the costs to achieve those savings should not be recoverable. (*Id*., p. 757) To the contrary, and as described in more detail below, some costs to achieve savings may indeed be recoverable in a future rate case – but not costs incurred in accomplishing the reorganization[6]. Savings in their purest form should be flowed through to the costs associated for consideration in setting rates by the Commission, unadulterated by "offsets" from multifarious costs incurred in accomplishing the proposed reorganization[7].

4. Recovery of Costs Incurred in Accomplishing the Proposed Reorganization

a. Staff's Recommendation

In their direct case, the Joint Applicants did not seek recovery of any costs related to the reorganization. In fact, Joint Applicants witness Linginfelter stated:

> Given that (i) there are no savings allocable to Nicor Gas resulting from the Reorganization, and (ii) we are not seeking recovery of costs related to the Reorganization, there is nothing for the Commission to rule with respect to Section 7-204(c). (JA Ex. 1.0, pp. 13-14, emphasis added)

Also, Joint Applicants witness Reese stated:

> But again, we have not identified any net savings so we are not requesting recovery of those costs in this filing. (JA Ex. 5.0, p. 12, emphasis added)

Given that the Joint Applicants did not request cost recovery, Staff recommended the Commission find that the Join Applicants should not be allowed to recover any costs

[6] See the discussion below regarding the differences between costs in accomplishing the reorganization and other costs *attributed* or *related* to the reorganization.
[7] Staff Ex. 13.0 discusses numerous dockets in which the Commission issued rulings similar to Staff's recommendations regarding both allocation of savings resulting from proposed reorganizations and recovery of costs incurred in accomplishing proposed reorganizations.

incurred in accomplishing the proposed reorganization in this or any future proceeding. (Staff Ex. 7.0, pp. 3-4)

b. Joint Applicants' Amendment to Staff's Recommendation

In response to Staff's recommendation, the Joint Applicants stated in rebuttal testimony:

> Therefore, the Joint Applicants will accept Mr. Bridal's proposal regarding cost and savings if it is amended to reflect the fact that any savings should be measured net of the costs to achieve them. Accordingly, the Joint Applicants propose that the condition include the following:
>
> > In the event that any party, other than Nicor Gas, causes or requests a review of Nicor Gas' earnings during the five year period following the completion of the Reorganization, Nicor Gas shall be afforded the opportunity to request the Commission consider inclusion of a test year amortization (1/5 of the total cost of the Reorganization as stated in response to Staff Data Request RWB 1.03 (Mr. Effron refers to these costs as "merger costs")) in determining revenue requirement in that proceeding.
> >
> > This language would not commit the Commission to allowing recovery, but would provide Nicor Gas with the opportunity to argue for recoverability of the costs to achieve savings realized in the context of that case. Assuming no case arises during that five year period, Mr. Bridal's recommendation would be the result. (JA Ex. 8.0, pp 19-20)

Staff does not support the amendment set forth by the Joint Applicants. The amendment is in conflict with Staff's primary recommendation to disallow recovery of costs incurred in accomplishing the proposed reorganization. The Joint Applicants' amendment also does not follow the requirements of Section 7-204(c)(ii) of the Act.

Regardless of whether any of the costs incurred in accomplishing the reorganization help achieve cost savings, Staff's recommendation is that those reorganization costs not be recovered, and that all cost savings resulting from the

reorganization be flowed through for consideration in setting rates. This is appropriate, given that the Joint Applicants failed to provide any analysis of potential savings or tangible benefits from the proposed reorganization to ratepayers, and there still is no showing of ratepayer benefits. The Joint Applicants' suggested amendment would effectively allow costs incurred in accomplishing the proposed reorganization to be recovered as a reduction to cost savings. Following Staff's recommendation, if the reorganization results in synergies or any other type of cost savings for Nicor Gas, all of those cost savings would be flowed through as reduced costs for consideration in setting future rates – in just the same manner as test year costs were flowed through to rates in the last rate case, absent the reorganization[8]. Staff's recommendation specifically excludes from recovery, in this or any future proceeding, the costs incurred in accomplishing the reorganization. (Staff Ex. 13.0, pp. 7-8)

c. Costs Incurred in Accomplishing the Proposed Reorganization

The costs incurred in accomplishing the proposed reorganization were updated to their most recent amounts in a supplemental response to Staff data request RWB 3.01, Exhibit 5. This schedule sets forth $129.8 million in costs incurred in accomplishing the reorganization separated among five major categories: Transaction Costs, Change in Control Costs, Financing Costs, Separation Costs, and Legal and Other Professional Costs. (Staff Group Cross Ex. 2 (Public), p. 8) While Staff maintains that no costs incurred in accomplishing the proposed reorganization should be recovered, AG/CUB spoke towards only two categories of costs incurred in

[8] Until the time of the utility's next rate case, all cost savings recognized from the reorganization would flow to the Joint Applicants. Upon conclusion of the next rate case, those cost savings would be flowed through to ratepayers via the revenue requirement used to set future rates.

accomplishing the proposed reorganization which should not be recoverable from Nicor Gas ratepayers: Transaction Costs and Change in Control Costs.

AG/CUB describes both Transaction Costs (fees to financial advisors) and Change in Control Costs (payments to executives terminated in conjunction with a change in control) as costs associated with the change in ownership of Nicor, Inc., and states these costs should not be recoverable from Nicor Gas ratepayers in any circumstances. (AG/CUB Ex. 3.0, p. 10) Staff concurs. The exclusion of Transaction Costs and Change in Control Costs along with any other reorganization costs not related to the utility operations is consistent with the Commission's treatment of similar costs in previous merger proceedings. Such costs are associated with the business end of the transaction, and should not be recovered because they are not directly associated with the provision of utility service. (Staff Ex. 13.0, pp 4-6) Further, the Joint Applicants conceded that Change in Control Costs should not be recoverable during cross examination, when Joint Applicants' witness O'Connor stated, regarding the impact of the cost of change in control agreements on Nicor Gas rates, "It would not be recoverable in a future rate case, were that cost to be allocated to Nicor Gas in the first place." (Tr., July 19, 2011, p. 464) Also regarding Change in Control Costs, Joint Applicants witness Reese stated, "To the degree that they are [severed] and these costs are incurred, then they would follow the allocation and methodology included in the services agreement." (*Id*., p. 585) These statements clearly indicate that Change in Control Costs should not be recoverable, and to the extent that one might possibly consider they could be recoverable, the amounts are a moving target and not known and measurable.

In Staff's view, recovery of Separation Costs should likewise be disallowed. There has been no quantification of the Separation Costs that should be born by Nicor Gas. Similar to Change in Control Costs, Separation Costs have been cast into the realm of the unknown, as "costs in this category apply to all of AGL Resources, Inc.'s as a combined entity. So they are not necessarily reflective of costs that are borne by Nicor Gas as it is today." (*Id*., p. 555) Further, the Joint Applicants state regarding costs identified on Staff Group Cross Ex. 2 (Public), page 8, "I don't think the 125 million, all of it, would be allocable to Nicor Gas" and "those would be fairly attributable to Nicor Gas on their pro rate share." (Tr., July 20, 2011, pp. 680, 682)

At the evidentiary hearing, a question was raised about costs that would be incurred in accomplishing the reorganization, but which are not incurred until after the merger is approved. (*Id*., p. 757) This could be an additional source of confusion surrounding costs incurred in accomplishing the reorganization, those of the type identified on page 8 of Staff Group Cross Exhibit 2 (Public), but that occur *after* the proposed reorganization is assumed to be approved. (*Id*., p. 757) In Staff's view, those types of costs should not be recoverable, regardless of when they are incurred.

To be clear, Staff's recommendation is that no costs incurred in accomplishing the proposed reorganization should be recovered in this or any future proceeding. However, if the Commission should determine that a portion of this class of costs is recoverable, the Commission must make a finding that states the amount of recoverable costs, and how those costs should be allocated. If the Commission were to allow some recovery of costs incurred in accomplishing the proposed reorganization, the amount allowed by the Commission would need to be specifically defined, set up as a regulatory asset, and amortized over a period found agreeable to the Commission. In defining the

amount allowed for recovery, the Commission would have to create a regulatory asset by making a determination of what amount of the costs on page 8 of Staff Group Cross Exhibit 2 (Public) should be ultimately allocated to the utility for recovery[9]. Regardless of when those costs are incurred, and regardless of the *actual* amount of costs ultimately incurred, recovery would be limited to the amount included in the regulatory asset, amortized over the period granted by the Commission. This approach is comparable to the allowance and amortization of similar regulatory assets, such as rate case expense.

However, Staff's proposal to not allow recovery of costs incurred in accomplishing the reorganization is the most viable option. The record contains no other proposal which enables the Commission to make a finding that fulfills the requirements of Section 7-204(c)(ii) of the Act. No other party has identified any specific amount of costs eligible for recovery, nor have they set forth a specific proposal of how those costs would be allocated. (Staff Ex. 13.0, p. 10) Staff is not aware of a single case in which the Commission has allowed recovery of costs incurred in accomplishing a proposed reorganization where the costs allowed for recovery were not specifically defined by a party and where an allocation method was not specifically proposed by a party.

5. Additional Consideration: Costs Incurred in Accomplishing the Proposed Reorganization vs. Costs *Attributed* or *Related* to the Proposed Reorganization

[9] As referenced above, Joint Applicants witnesses have stated these types of costs in total are not necessarily representative of costs that should be borne by Nicor Gas. For example, see Tr., July 19, 2011, p. 555.

Finally, in reaching a decision regarding the recovery of costs incurred in accomplishing the proposed reorganization, the Commission should be careful to distinguish between costs incurred in accomplishing the reorganization, and costs *attributed* or *related* to the reorganization, which is a separate and distinct class of costs. Both classes of costs were discussed at the evidentiary hearing. Such caution is required because of the potential to confuse the different classes of costs associated with a reorganization, some of which could indeed be proven to be recoverable in a future rate case. Costs incurred in accomplishing the reorganization are costs of the types identified on page 8 of Staff Group Cross Exhibit 2 (Public). Costs in this class should not be recoverable.

Costs *attributed* or *related* to the reorganization, that is, additional costs not of the types identified in Staff Group Cross Exhibit 2, are not addressed in Staff's pre-filed testimony, but were discussed by Staff during cross examination. (Tr., July 20, 2011, p. 757) One example of a cost that could possibly be *attributed* or *related* to the reorganization and not of the types identified in Staff Group Cross Exhibit 2, would be the cost of providing data backup centers within the combined organization, as discussed by Joint Applicants witness Linginfelter during cross examination. (*Id*., p. 676) Another example of a cost that could possibly be *attributed* or *related* to the proposed reorganization is the cost to standardize the combined entities on a common computer platform, as discussed by Joint Applicants witness O'Connor. (Tr., July 19, 2011, pp. 339-401)

Costs *attributed* or *related* to the reorganization could potentially be wholly or partially recovered in a future rate case if the operating utility successfully argues for the recovery of those costs through its revenue requirement in such a proceeding.

Recoverability of costs in this class would be determined by the Commission in its Order in that proceeding. Those costs should not be ruled on until such time that the utility seeks recovery in a rate case.

6. Conclusion

For the reasons stated above, in the event that the Commission should approve the proposed reorganization, Staff continues to recommend the Commission also make the following rulings:

a) All savings resulting from the proposed reorganization shall be flowed through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission (Section 7-204(c)(i) of the Act); and

b) Any costs incurred in accomplishing the proposed reorganization in this or any future proceeding shall not be recoverable through Illinois jurisdictional regulated rates (Section 7-204(c)(ii) of the Act).

IV. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations.

August 18, 2011

Respectfully submitted,

_____

Jennifer L. Lin
Janis E. Von Qualen
Megan C. McNeill

Staff Counsel

JANIS E. VON QUALEN
Office of General Counsel
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701
Phone: (217) 785-3402
jvonqual@ icc.illinois.gov

JENNIFER L. LIN
MEGAN C. McNEILL
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle St., Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
jlin@icc.illinois.gov
mmcneill@icc.illinois.gov